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TAGS: ECON ETRD PGOV EINV MX
SUBJECT: MONTERREY CONGLOMERATES FACE GLOBALIZATION WITH MIXED SUCCESS

¶1. (SBU) Summary. Monterrey's 'Group of 10' is composed of family owned industrial conglomerates that built Monterrey into an industrial powerhouse starting in the 19th century. The Group of 10 had tremendous economic influence and was reputed to have sizable political clout as well. Since the opening of the Mexican economy, highlighted by the NAFTA treaty in 1994, its interests have diverged, as several firms have become global companies, others continue as primarily Mexican businesses, and a few others have been sold. The flagship Monterrey company Cemex breaks the Group of 10 paradigm in several aspects through its international growth, focus on one product, and meritocracy. However, Cemex is characteristic of the Group of 10 with its focus on process innovation rather than developing new products. Several of the Group of 10 have been weakened by globalization and succession issues, endangering Monterrey's future as a business headquarters as opposed to a manufacturing site for foreign companies. End Summary.

Historical Influence of the Group of 10

¶2. (U) Monterrey remained a small trading city until 1890, when it began to industrialize through the founding of the Cuauhtemoc Moctezuma Brewery by members of the Garza, Sada, Muguerza and Calderon families. The Brewery later established a glass company, a cardboard box company and other companies to provide products for distributing beer. The companies remained family enterprises, with interlocking family control. However, as the founding and second generations died, the companies divided into the current Group of 10 member companies Alfa, Femsa, Vitro, Cydsa, De Acero and Pyosa. Cemex was founded by the Zambrano family in 1906, but it remained a small regional cement producer for many years, and thus Cemex did not emerge from the original brewery concern. At the same time the steel company Fundidora de Fierro y Acero de Monterrey, founded in 1900, began a tradition of steel production that has continued until today with IMSA (sold last year to the Argentine company Ternium), Hylsa (also sold by Alfa to Ternium) and De Acero. The original Fundidora de Fierro y Acero de Monterrey went bankrupt in 1986. The Group of 10 are still very large companies, and in 2005 an insider executive estimated that they had combined revenues of U.S. $45 billion, roughly 6% of Mexico's GDP.

¶3. (U) These companies also helped shape Monterrey through civic activities such as founding universities. Visionary local leader Eugenio Garza Sada, head of the Monterrey Industrial Group (which later was divided into Femsa and Alfa), founded the

leading private university, Monterrey TEC, in 1943 to train workers and managers for the companies. Monterrey TEC is still supported today by Cemex and Femsa, and executives from these two companies are plentiful on the universities governing board.
In 1969 the Monterrey Industrial Group helped found the University of Monterrey (still supported by Alfa) and Vitro founded the Universidad Regiomontana. In addition, the Group of 10 companies established hospitals (e.g. the Cristus Muguerza hospital), local parks like Planeterio Alfa, and sponsored cultural events such as the recent International Cultural Forum.

¶4. (SBU) The Monterrey Group of 10 were also reputed to have had substantial political clout. Post heard from several sources how in the past the Group of 10 companies controlled Monterrey, and through their economic power and political influence they set the policy agenda for the city. That has changed, and all of our contacts agree that the Group of 10's political influence has waned, and although still influential, they no longer can dictate policies to city officials. Guillermo Dillon, Executive Director of the Business Association CAINTRA, affirmed that the Group of 10 no longer can run Monterrey by themselves, and they must seek alliances with government officials and other businesses. The Group of 10's power has always been hidden, and several of our business contacts questioned whether they still meet and which companies were in the Group of 10. However, Post understands from executives within the Group of 10 that the chief executive officers still meet monthly, and no substitutes for the CEOs are permitted at these closed meetings. According to our contact, the Group of 10 CEOs discuss political issues such as the 2006 Presidential candidacy of Andres Manuel Lopez Obrador, President Calderon's fiscal reform, and benign topics such as dividing charitable contributions. Although their influence is cloaked, we understand they still have access to the highest political levels in Mexico. They also meet with other VIP visitors. For example, when California Governor Arnold Schwarzenegger visited Monterrey in November 2006, the Group of 10 arranged for a private meeting with Governor Schwarzenegger at one of their

homes.

Mexico Opens its Economy

¶5. (SBU) Monterrey's Group of 10 companies began by focusing on the Mexican market, and since the national economy was largely closed they were sheltered from international competition. Roberto Guerra, Director General of the Monterrey division of Fitch Ratings, described to us how, in turn, the Group of 10 companies generally supported the PRI governments, and in turn they received government help to close off imports. However, in 1983 the Mexican government began to eliminate import license requirements, official import prices, and qualitative restrictions. The trade liberalization program sought to make Mexican producers more competitive by providing affordable inputs and prodding them to become international companies. By 1985 the share of total imports subject to licensing requirements had fallen from 75% to 38%. In 1986 Mexico acceded to the General Agreement on Tariffs and Trade (GATT), and in 1987 Mexico agreed to a major liberalization of bilateral trade relations with the United States. As a result, the share of domestic output protected by import licenses fell from 92% in 1985 to 18% by the end of 1990. The maximum tariff was lowered from 100% in 1985 to 20% in 1987, and the weighted average tariff fell from 29% in 1985 to 12% by the end of 1990. The volume of imports subject to entry permits was reduced from 96% of the total in 1982 to 4% by 1992. The crowning touch was the NAFTA agreement, concluded in 1993, permitting free trade and foreign investment between the United States, Canada and Mexico.

Group of 10 Reacts to Globalization

¶6. (U) Mexico's trade liberalization presented the Monterrey Group of 10 with both a challenge and an opportunity. For the

first time the Monterrey industrialists faced strong international competition. However, they also received an enormous opportunity to build international companies, particularly given their lower labor costs and proximity to the United States, the largest market in the world. Based on Econoff's discussions with academics, business consultants, business association leaders, and executives from private companies, there is a clear consensus that Cemex has transformed itself into a premier international company, Alfa and Femsa have developed strong international presences, and Vitro and Cydsa are having great difficulty, IMSA and Hysamex have been sold to a foreign company. Of the four remaining companies, Xignux and Proeza have developed internationally, while De Acero and Pyosa remain primarily focused on Mexico.

¶7. (SBU) Although a number of the companies are listed on the New York or Mexican stock markets, the Monterrey Group of 10 companies remain family conglomerates. Except for Cemex, which is primarily owned by 15 families, the Monterrey Group of 10 firms are typically owned by one or two extended families, and family members are chief executives of the companies. Our contacts report that some of the companies are listed in part for tax benefits, because they can transfer a certain percentage of ownership to the next generation without paying taxes. In addition, Vitro and Cydsa have recently bought back their stock, according to a business consultant, to avoid market discipline by stockholders. Although the conglomerates normally have a board of directors, the board does not control the company and is not truly independent. Indeed, in some cases the slots for independent directors are filled with former employees or other Group of 10 family members, creating an interlocking network of friends, family and associates. Talented outsiders have the ability to climb the corporate ladder at certain firms, such as Cemex, Alfa and Femsa, but even then there are cases where professional managers have been dumped in favor of promoting family members.

¶8. (SBU) As with all family companies, the most difficult issue is succession. Post understands when a CEO dies or retires, the family normally gathers and picks the most capable of the next generation to run the business. However, in some cases, there are family disputes, which sometimes results in dividing up the companies into differing ines of business for the various sons (not daughters) to run. However, as the Monterrey companies reach the third generation, with a greater number of heirs, there is also pressure to sell the company and divide the proceeds, as apparently occurred with the steel company IMSA.

Profiles of the Monterrey Group of 10 Companies

The Maverick Cemex

¶9. (U) Cemex is the exemplar of an international Monterrey company, with operations in over 50 countries. Cemex is the world's largest building materials supplier and third largest cement producer. Although Cemex was founded in 1906, it was a regional cement producer until 1976 when it acquired other Mexican cement companies to become the largest Mexican cement producer. Since then Cemex has aggressively purchased other international cement producers, including in Spain, Venezuela, Colombia, the Philippines, Egypt, and the United States. In 2005 Cemex acquired London based RMC Group for U.S. $5.8 billion to expand in Europe, and in 2007 Cemex bought the Australia based Rinker for U.S. $15.3 billion to increase its presence in the United States. Cemex's rise has been directed by Lorenzo Zambrano, whose grandfather founded the company. Zambrano joined the company in 1968, and became Chief Executive Officer in 1985. Cemex's sales increased from U.S. $3.4 billion in 1996 to U.S. $18.2 billion in 2006, a compounded annual growth rate of 18%. Cemex purchased Rinker during the U.S. construction boom. Not every acquisition pays off immediately, and in December 2007 Cemex laid off 10% of its work force worldwide to cope with decreased sales due to the slowdown in the United

States housing market.

¶10. (SBU) Cemex has become an international company by breaking the family conglomerate mold. Cemex originally was a minor member of the Group of 10, far smaller than the predecessors to Alfa, Femsa, Vitro and Cydsa. However, now Cemex so overshadows the others that local business consultants joke that the 'group of 10 has become the group of one'. Cemex focused on just one product, the basic commodity of cement, and does not have three of four lines of businesses typical of the family conglomerates. Cemex is also owned by 15 families, so there is closer resemblance to traditional stockholders. Cemex has successfully made process innovations allowing it to ship concrete long distances, and finance its international acquisitions cheaply. Cemex hires and promotes much more based on principals of merit, not family ties. A professor from the leading Monterrey business school, Monterrey TEC, reports that Cemex hires the cream of the crop. An analyst for HSBC bank commented that Cemex has world quality leadership and a deep bench of smart executives, often educated in elite foreign universities. Cemex is also known for the very long hours logged by its executives. Econoff has visited both Cemex and Vitro, and there are striking differences in the atmosphere of the companies. In Cemex employees labor away in cubicles, while Vitro maintains the old world charm of elegant furnishings, ample staff to fetch coffee, and private bathrooms for every junior executive.

¶11. (SBU) Cemex's institutional strengths are also fortified by profits from a captive Mexican market. According to the book Grey Gold, written by a respected journalist, Cemex has 51% of the Mexican cement market and Mexican consumers pay above the world price. Cemex has also acted to prevent cement imports. An interesting passage of Grey Gold describes how in 2004 three former Cemex employees formed a new company to import foreign cement into the Mexican market. They eventually contracted a Jordanian ship to bring Russian cement to Mexico. However, when the ship landed in the Mexican port of Altamira, Cemex led other Mexican cement companies to file a legal appeal to block the ship from unloading the cargo. The legal case continued for 11 months, at a loss to the importers of U.S. $30,000 per day, until they finally gave up and shipped the cement to Africa.

Alfa: A Successful Conglomerate

¶12. (U) Alfa is a large successful international company focusing on core businesses of autoparts, food, and petrochemicals. Alfa had U.S. $7 billion in revenues in 2006, production facilities in North America and Europe, and sales in over 40 countries, accounting for 44% of total revenue. Alfa was formed after the death of the family patriarch Eugenio Garza Sada in 1973, when the flagship Monterrey Industrial Group was divided into Alfa, controlled by the Garza-Sada family, and Femsa, controlled by Garza-Laguera family, with the Muguerza and Calderon families retaining minority shares. Alfa has evolved over time. In 1993, the petrochemical, food and auto parts units only constituted 35% of earnings, while steel was 34% and synthetic fibers contributed 31%. Since then Alfa divested its steel company Hylsamex to the Argentine steel producer Ternium in 2005 (at an excellent price), and greatly reduced its reliance on synthetic fibers. By 2006 the petrochemical division (43%), processed food (31%) and autoparts (19%) contributed 97% of earnings. Alfa is listed on the Mexican

stock exchange, and its directors include the heads of Cemex and Vitro. According to a financial consultant, Alfa has 'played the conglomerate game well,' moving quickly to invest in areas such as aluminum cylinder heads (for cars) in Europe as the U.S. market weakened. A business school professor agreed that after Cemex, Alfa and Femsa are popular choices for rising young Mexican executives, and there are considerable opportunities for talented outsiders to rise up in these companies.

Beverage Giant Femsa Looks South

¶13. (U) Femsa is the direct descendent of the original brewery that started Monterrey's industrial development in 1890. Femsa today is an international corporation focusing on beer, soft drinks and convenience stores. Femsa's revenues are growing strongly, doubling since 2002, to U.S. $11.7 Billion in 2006. Femsa's revenues derive from three sources, Femsa's joint venture with Coca-cola (45%), beer (28%) and Oxxo convenience stores (similar to 7-11) (28%). Like Cemex, Femsa has grown through international acquisitions, such as Panamco in 2002, the largest Coca-cola bottler in Latin America (and one of the three largest in the world), and Femsa has continued smaller purchases, including the Brazilian brewery Kaiser in 2006. Femsa has grown smartly in Mexico, doubling the number of OXXO convenience stores from 2002 to 2006, which have displaced the traditional Mexican small store (tienda). Femsa has operations and sales throughout Central America, Colombia, Brazil, Venezuela, and a beachhead in Argentina. Femsa is listed on the New York and Mexican Stock exchanges. Moreover, Femsa just received a vote of confidence, since Microsft's Bill Gates invested U.S. $392 million in Femsa in December 2007.

Vitro: The Glass Dinosaur

¶14. (U) Vitro is one of the founding groups of the Monterrey Group of 10, from the unit that provided beer bottles for the brewery. Vitro is still a substantial company, with U.S. $2.5 billion in sales, and Vitro's core businesses are in glass containers (beverages) and flat steel (for the auto industry). Vitro manufactures in eight countries, exports goods to 40 countries, and, according to Vitro, only 43% of its sales are within Mexico. Vitro ran into trouble in the 1990s, when it had large debts denominated in dollars, which became a heavy burden after the 1994 devaluation. Since 2001 Vitro has been shedding non-core assets, such as joint ventures and real estate, and has refinanced its debt to reduce a very heavy dollar debt burden. Still, Vitro's revenues have stagnated since 2002. Vitro has also faced external challenges such as high energy costs (14% of their total costs), beverage containers moving from glass to plastic, and the slowing U.S. auto industry. Vitro previously owned a large share of Cydsa, which it sold to raise money, and although it is listed on the New York Stock Exchange, the Sada-Gonzalez family continues to control the company.

¶15. (SBU) Econoff met with business consultants, financial analysts, industry leaders, and they all cited Vitro as an example of a poorly managed conglomerate. According to several business consultants, Vitro's plants are obsolete and they face more efficient international competition. Vitro's markets also have relatively low barriers to entry, increasing the pressure on Vitro. Vitro has missed many opportunities, such as when it sold out its joint venture with Whirlpool in 2002. Whirlpool now has a large facility, including a research center, here in Monterrey, with substantial exports of home appliances to the United States. As previously mentioned, Vitro has a genteel old world business atmosphere, and our contacts believe that advancement in Vitro is based less on merit than connections. An executive from another company thought that family in-fighting has drained Vitro of energy. One business insider commented 'I don't see a future for Vitro.'

Cydsa: Another Former Giant In Trouble

¶16. (SBU) Cydsa is a petrochemical and textile company which has had difficulty coping with globalization, as it focuses on reducing debt and shedding assets to maintain its economic viability. Cydsa was founded in 1947 with capital from the main Group of 10 partners, and today is owned and managed by one branch of the related families. Cydsa manufactures chemicals and plastics, fibers and textiles, flexible packaging and water treatment plants. Cydsa incurred very heavy debts (denominated in dollars) in the 1980s and 1990s, and recently it has shed assets and focused on debt reduction. Cydsa has also struggled with high energy costs and foreign competition in textiles. As a result, Cydsa is a 'shadow of its former self' according to a business consultant, and its net sales have declined from U.S.

$892 million in 1991, $814 million in 1999, to the nadir of $381 million in 2001, but Cydsa recovered to $536 million in 2006. Cydsa also has minimal profits, with U.S. $31.6 million in losses in 2005 and only U.S. $1.6 million in profits in 2006. Cdysa manufactures its products in Mexico, and exports only constituted 18% of its sales in 2006. Our contacts see Cydsa as a lumbering family conglomerate, based more on family and offering few opportunities for talented outsiders. The same business insider who was pessimistic about Vitro said that Cydsa was 'not doing well, and is ready to disappear'.

IMSA: The Family Cashes Out

¶17. (U) The traditional and well-connected Monterrey family which owned IMSA, an established Monterrey steel company, sold it in 2007 and distributed the substantial proceeds between the family members. IMSA was founded in 1936, and it produced steel processed products and aluminum and plastic construction products. In 2005 IMSA had manufacturing and distribution facilities in Mexico, the United States, Europe and Latin America, and IMSA had revenues of $3.6 billion, and almost 50% of its sales were exports. However, IMSA faced high energy costs, tough foreign competition, and internal family disputes. IMSA had been owned by the Canales and Clariond families, but in 2006 Fernando and Marcelo Canales purchased all of the shares from the Clariond family, and so the Canales family owned 91% of IMSA's shares. In 2007 IMSA was sold for over U.S. $3 billion to the Argentine steel firm Ternium, and according to press reports, after paying off IMSA's debt, the Canales family received over U.S. $1.5 billion. Note. Fernando Canales was Governor of Nuevo Leon from 1997-2003. End Note.

¶18. (SBU) Although IMSA faced strong international competition, our contacts think that the Canales family primarily sold IMSA because there were family disputes over how to divide up resources. According to one researcher on family firms with the University of Monterrey, families face pressure with succession, because the next generation may not have the interest or ability to carry on the business. This appears to be the case with IMSA, as the next generation was not interested in the businesses and it was easier to sell and distribute the proceeds. Although the Canales family proclaimed that they were entrepreneurs and would invest in new businesses, there is little evidence that this has occurred. In fact, two insiders reported to us that the next generation of the Canales family now own foreign luxury car dealerships and discos, with no other apparent investments.

Four Successful Monterrey Companies: Xignux, Proeza, DeAcero, and Pyosa

¶19. (SBU) Several of our business contacts pointed to Xignuz as an example of a smaller successful international Group of 10 company. Xignux was founded in 1956 with seed capital from the founder's father, the President and CEO of Vitro. Xignux started with a wire and cable business, and now focuses on high quality products for industrial use, such as electrical harnesses and cable for automobiles and power and distribution transformers, and processed food. Xignuz has production facilities in Mexico, the U.S. and Central and South America, and earns almost $3 billion in annual sales, half from outside Mexico. Xignux has joint ventures with General Electric and Sara Lee. A Xignux executive described these joint ventures as a means to expand Xignux's global expertise before its big push to expand internationally. The second generation now heads Xignux, and it is expected to maintain control for the foreseeable future.

¶20. (U) Proeza is another successful Group of 10 company, with an estimated U.S. $6 billion in sales in 2005. Proeza focuses on automotive parts, fruits and fruit juices, foundries and even an information technology service. Proeza was founded in 1956 by a member of the Zambrano family, and its main subsidiary is Metalsa, which supplies structural steel components for cars and trucks and produces primarily for the North American automotive market. Proeza is a private company, so less information is available about it. Proeza has factories in Mexico, the United

States and India, and sells to over 30 countries. Our business contacts generally see them as well run, although one warned that in 10 years Proeza could face succession issues as it moves to the next generation.

¶21. (U) De Acero is a private company manufacturing steel products in Mexico, and distributes to 20 countries in the United States, Central America and Europe. De Acero is a privately held company, and we could not locate financial

information. De Acero was founded in 1952 by the Muguerza family, which still leads the company today. Our contacts describe De Acero as a well-run firm but with little foreign presence.

¶22. (U) Pyosa is also a private company, which was founded in 1938, and produces various chemical products for industrial clients, including paints, inks, textiles, coatings, plastics, car batteries and detergents. The chief executive officer is the older brother of the unsuccessful PAN gubernatorial candidate in Nuevo Leon in 2003. The company's manufacturing is based in Monterrey, and its sales appear to be focused on Mexico. [Note: Several of our contacts provided slight variations of which companies were in the Group of 10 End Note.]

¶23. (U) Aside from the Group of 10, there are other important Mexican and international firms in Monterrey. Some of the leading Mexican companies include Gruma (tortillas and corn), Arca (beverage), Value Casa de Bolsa (corporate finance), Banorte (Mexican bank) and Soriana (supermarket chain). There are also numerous foreign companies with large investments in Monterrey. Now the Group of 10 does not even speak for the entire Monterrey business community.

Comment:

¶24. (SBU) Comment. It is clear that the Monterrey Group of 10 conglomerates have responded differently to the challenge of globalization. Several have prospered; others have floundered. One key appears to be a company's openness to talented outsiders, which not only attracts ability outside of the immediate family, but also changes the culture of the company. The Monterrey Group of 10 has also lost political influence, which many in Monterrey business circles attribute to a weaker and more materialist third generation. Although this is true in certain cases, the more fundamental reason may be that the Monterrey Group of 10 no longer face as many common issues, as some struggle to survive in Mexico, while others compete globally.

¶25. (SBU) One striking aspect of the Group of 10 is that its international success is due to acquisitions and process improvements, not new Mexican products. The flagship company Cemex produces cement, a commodity product, and it does so very efficiently. Some of the other companies focus on auto parts (a very strong business in Mexico now), beverages and food products. Although there may be incremental improvement in these goods, they are not products developed by the Group of 10. Many Group of 10 companies formerly focused on heavy industrial items such as steel or petrochemicals, but have been hurt by high energy costs. Several steel units have been sold, and petrochemical giant Cydsa has weakened.

¶26. (SBU) Monterrey often pays homage to the Group of 10 as part of its industrial development, but the real question is whether the Group of 10 conglomerates are viable entities or vestiges of the past. Post believes that the larger Monterrey companies will continue to flourish, although some of the weaker Group of 10 companies may contract further or the families may choose to sell. Going forward, the key will depend less on Monterrey family connections and more on the ability to compete on an international level. End comment.
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